

## **Commissioner's Directive #2**

**February 17, 1976**

**SUBJECT: Taxation of Indiana Destination Sales under the Gross Income Tax Act.**

### **Introduction**

The purpose of this directive is to outline the Department's position on the treatment of Indiana destination sales under the Gross Income Tax Act. Central to this position is the Department's interpretation and application of the existing state and federal cases on this subject.

### **Case Law**

The two recent Indiana cases dealing with this subject are Gross Income Tax Division –v- Owens-Corning Fiberglass, 251 N.E. 2d 818 (1969) and Mueller Brass Co. –v- Gross Income Tax Division, 265 N.E. 2d 704 (1971). Both these cases dealt with sales initiated, negotiated and serviced by out-of-state home office personnel of the taxpayer and home office personnel of the Indiana customer. The court recognized that these sales would be non-taxable if the contact by the Indiana personnel of the taxpayer was either non-existent or insignificant. The Mueller Brass case also discussed the taxability of sales when the State is divided into territories. Sales made to customers in northern Indiana by Mueller Brass were viewed as non-taxable because: 1) the orders were initiated by out-of-state personnel; 2) the goods were shipped into Indiana from another state; 3) the orders were mailed to out-of-state offices where acceptance was made and payments received, and 4) the contact with the taxpayer's office in the southern territory was incidental to the sales. The court, however, noted that sales generated in the southern territory by the Indianapolis office were taxable even though the orders were sent out-of-state for acceptance. The activities of the Indianapolis salesmen consisted of furnishing information on new products, assistance with engineering applications, product installation lessons, follow-up assistance on orders and providing a source of communication with the manufacturer.

The two U.S. Supreme Court decisions dealing with this subject are General Motors Corp. –v- Washington, 377 U.S. 436, 84 Sup. Ct. 1564, (1964) and Standard Pressed Steel Co. –v- Washington, 95 Sup. Ct. 706, (1975). In the General Motors case, the court upheld Washington's taxation of General Motor's unapportioned gross receipts from wholesale sales to its Washington dealers of motor vehicles, parts and accessories manufactured outside the state. The court felt that the presence of warehouses and 40 employees within the state constituted a "bundle of corporate activity." In the Standard Pressed Steel case, the court found that the activities of the taxpayer's employee, Martinson, in Washington lead to the realization and continuation of "valuable and lasting contractual relations" between the taxpayer and its customer, Boeing, which gave rise to sales subject to taxation. The employee, who did not solicit orders, used his technical expertise and goodwill to promote his company's products. The orders, for aerospace fasteners, were negotiated between Boeing and the taxpayer's home office personnel in Pennsylvania.

In applying the above cases, the Department also looks to the principles enunciated in Norton Company –v- Department of Revenue of Illinois, 340 U.S. 534, 71 Sup. Ct. 377 (1951). Norton was a Massachusetts

manufacturer with a branch office and sales outlet in Chicago. The home office, in Massachusetts, received orders from Illinois customers by direct mail and through the Chicago branch. Some orders received by direct mail were filled by shipment direct to customers from Massachusetts and some were filled by shipping to the Chicago branch from which they were delivered to the customers. The court ruled that receipts were taxable if the business was channeled through the Chicago branch either in obtaining the orders or in making deliveries although the goods were shipped from Massachusetts.

### **Discussion**

Each of the above discussed cases enunciated broad principles dealing with the subject of taxation of destination sales. Each case also has limited scope: 1) In Mueller Brass and Owens-Corning, the non-taxability of "house accounts" was upheld due to a lack of any substantial Indiana contact with the sales. Thus, these cases cannot be read as affording a blanket exemption to house accounts. As the Standard Pressed Steel case points out, the substantial activity by Martinson was enough to tax what was clearly a house account between the taxpayer and Boeing. 2) The decision of exempting sales made into northern Indiana by Mueller Brass was again upheld because the southern territory operations only had incidental contact with these sales. The court did not address itself to whether the sales would be taxable if the Indianapolis office salesmen performed activities in northern Indiana as they did in southern Indiana. 3) In General Motors, the car, parts and accessory sales were taxed because the taxpayer's divisions generating those sales had a "bundle of activity" in Washington. Sales by other divisions whose activity was incidental in comparison to the motor vehicle division's bundle of activity were not considered taxable. The Department has adhered to this distinction when dealing with a large corporation having many operations (such as divisions or product lines) with varying levels of Indiana activity. 4) In Standard Pressed Steel, the state did not tax sales made to other customers in Washington where there was an absence of "valuable and lasting contractual relations" by its employees. The Department recognizes the validity of this distinction and has applied this case only in situations where one or more employees of the taxpayer, in their Indiana activity, is directly responsible for "valuable and lasting contractual relations" between the taxpayer and its Indiana customer or where a taxpayer also has a bundle of activity in its Indiana operations.

It is also important to note that the Department is not applying adjusted gross income tax standards on taxing Indiana destination sales for gross income tax purposes. Under the adjusted gross income tax, all destination sales must be reflected in the numerator of a taxpayer's sales factor in his activities within the state are beyond mere solicitation as defined in Public Law 86-272, 73 Stat. 555, 15 U.S.C § 381 (1959).

The Department feels that decisions on the taxability of Indiana destination sales can only be determined on a case by case analysis of all relevant factors. A pending matter may have aspects of all the above discussed cases and the Department's aim is to use the decisions to separate the taxable and non-taxable income. What must be emphasized is that the Department will be consistent in the application of these cases and will use the case or cases which best exemplify the operations of the particular taxpayer being examined.